

REA LAW JOURNAL

DEPARTMENT OF AGRICULTURE

RURAL ELECTRIFICATION ADMINISTRATION

Vol. 1. No. 11

October, 1939

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WHAT A COOPERATIVE'S LAWYER SHOULD KNOW

Any lawyer who expects to function effectively as legal adviser to a cooperative association cannot be satisfied merely with a study of the particular law under which the association is incorporated and an acquaintance with the charter and bylaws under which it is supposed to operate. He must recognize the basic differences between the ordinary business corporation and the cooperative way of doing business. He must try to understand the nature and purpose of organized cooperation and he must be sympathetic to cooperative objectives.

An understanding of present-day cooperatives becomes much easier if one is acquainted with the history of cooperation and its evolution on a world-wide basis. There is a vast amount of printed information available to the interested student. Several government departments have issued studies and bibliographies on various phases of the cooperative movement and the Cooperative League of the U. S. A. has for sale a great variety of informative material on cooperation both here and abroad. The space limitations of the REA Law Journal prevent any detailed review of this development and of the literature concerning it.

During the past hundred years, cooperative enterprise has gained recognition as a legitimate form of enterprise. In some countries and in some fields it has even gained a prominent place beside private enterprise. In such countries as Sweden and Finland, for example, it is generally

recognized as one of the most important and beneficial elements in the national economy.

The Bureau of Labor Statistics of the U. S. Department of Labor reports that in 1937, the latest year for which international statistics are available, more than 127 million families, in 61 countries, belonged to some kind of cooperative enterprise. It also estimates that there are about 750,000 cooperative associations now operating in these countries.

A recent survey by the Farm Credit Administration takes account of 15,000 farmers cooperatives in America, with a membership of more than 3 million persons. If we add to that number the urban cooperatives, the mutual telephone associations and the credit unions, we reach a total of some 30,000 cooperative associations in this country, with an estimated unduplicated membership of 5 million persons.

In his introduction to the WPA publication, "Index of the Laws pertaining to Cooperation"*, the editor, Mr. Tere-shtenko, points out that laws dealing with cooperatives are now to be found in 129 states and countries. He goes on to say that "Historically the striking feature in cooperative development has been the fact that the practice always preceded the law, and that governments, after being confronted with a form of organized economic activity for which existing law did not adequately provide, started passing necessary legislation, and the tendency always was to minutely fix by statutory regulation that which had heretofore been regulated by the

individual society dependent upon methods and procedure necessitated and proved by custom and usage."

This process of shaping the law to conform it to recognized cooperative needs is still going on. The REA Law Journal contains frequent indication of that fact. The first recent case in this issue is a noteworthy example of this development. The REA program, pioneering in the field of cooperative distribution of electricity, is continuously faced with legal problems which cannot be dealt with by rote because the novelty of the program frequently leaves it without the benefit (sometimes of doubtful value) of established precedent and crystalized and accepted legal opinion. Laws and decisions whose applicability to private utilities is unquestioned may, on close scrutiny, be found to have no or only modified application to an electric cooperative.

The attorney who has a basic understanding of cooperative philosophy, of the nature and functions of cooperative enterprise and of the practices and methods which cooperatives the world over have found useful and effective, will be a better legal adviser to a cooperative than an equally competent attorney who lacks this basic understanding.

(To Be Continued)

Udo Rall

REA Cooperative Consultant

*Obtainable from the U. S. Works Progress Administration for the City of New York.

RECENT CASES

Cooperative Associations - Distinction Between Patronage Refunds and Profits

Montana corporation license tax provides for payment by incorporated associations of a certain percentage

of their net income. A cooperative association, organized under Montana Rev. Code (1935) Section 638, sought to deduct in computing its net income (1) a six per cent dividend on the paid-up capital stock; (2) a patronage refund. Held, (1) the dividends paid on the paid-up capital stock are, prior to distribution, part of the Cooperative's profits and therefore do not constitute an allowable deduction; (2) The patronage refund is part of the expense of running the Cooperative and is not part of the profit of a Cooperative, and therefore is an allowable deduction. Gallatin Farmers Co. v. Shannon, 93 P. (2d) 953 (Mont. 1939).

This decision is as welcome to cooperators as it is sound. It makes very clear the fact that a patronage dividend is a considerably different thing from the traditional stock dividend, and that a cooperative in making a patronage refund is not making a distribution of profits. It has long been recognized by students of the cooperative movement that a patronage refund is nothing more than a return by the Cooperative to its members of the amount of overcharge paid to the Cooperative by its members for its services. The acceptance by the court of this basic cooperative principle marks a further advance in the field of cooperatives.

The court stated, in speaking of the patronage refund: "They are in no sense profits of the corporation that redound to the benefit of its stockholders. Patronage dividends are not distributed on the basis of stock ownership. Though the patrons be also stockholders, the allocation or distribution is not made on the basis of stock-membership but on the amount of patronage given to the corporation." The court quoted with approval the opinion in Uniform Printing and Supply Co. v. Comm'r. of Int. Rev. 88 F. (2d) 75, 76, 109 A. L. R. 966 (1937) stating:

"Had the taxpayer given a customer (whether stockholder or outsider) a discount promptly after filling

REA LAW JOURNAL

A review of that portion of the law important and interesting to attorneys working in the field of rural electrification.

Published Monthly

The Journal is informational only and should in no wise be interpreted as expressing the views of the Rural Electrification Administration or any division thereof.

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the order, no one would call it a dividend. If a rebate were given promptly upon the customer's business reaching a certain volume, the same conclusion as to its character would follow. To make cost estimates and adjust them at or near the end of each year returning the excess payment to the customer should not change the reasoning which leads to this conclusion. Nor should the fact that the customer is a stockholder materially affect the result. Perhaps a single refund coming at the end of each year would lessen the irresistibility of the inferences, but the conclusion would still fit the facts better than one founded on a dividend assumption.... Payment to the customers, who are also taxpayers, of sums called refunds based upon the volume of business transacted and in no way dependent upon stock ownership, is the determinative factor. Considering all the facts we conclude that the payments in issue were made as refunds rather

than as dividends to stockholding customers."

In a concurring opinion, Chief Justice Johnson stated:

"Virtually the sole reason for the existence of cooperative associations is the saving to their members and patrons which is expressed through patronage dividends. Except for limited authorized application to dividends on capital stock and the establishment of a reserve fund and an educational fund, any and all excess of receipts over the usual operating outlays is mandatorily required paid on patrons' purchases and employees' wages and salaries. Certainly these patronage dividends comprise ordinary and necessary expenses of cooperative associations."

Mortgages - Inadequacy of Acknowledgment --- Time When Curative Instrument Takes Effect.

In 1933 corporation executed a mortgage. Acknowledgment was in statutory form except that there were omitted the words, "with whom I am personally acquainted, or to me personally known", or like words showing personal acquaintance by the probating officer with the persons executing the mortgage. The acknowledgment did state that the officers of the corporation "personally appeared" before the probating official. After bankruptcy had intervened, a curative instrument was recorded, properly acknowledged. Held, the original mortgage was invalid as to creditors, and the curative instrument could have no retroactive effect. In re Englewood Mfg. Co., 28 F. Supp. 653 (S. D. Tenn. 1939).

The court found that the words "personally appeared" were not equivalent to personal acquaintance, and that the statute required that the personal acquaint-

tance of the executing officers and the probating official. The recording of an improperly executed instrument does not constitute notice to the creditors, and therefore the lien of the trustee in bankruptcy is prior to the lien of the curative instrument. The fact that the defect was cured could not render such validity to the original instrument as to displace liens which had intervened.

Notice - Provision That Mailing of Notice of Assessment Shall Constitute Conclusive Evidence of Receipt.

Mutual Fire Insurance Company amended its bylaws to provide that the mailing of a notice of assessment shall be conclusive evidence of its receipt by the members. A member failed to pay the assessment, and when suit is brought for payment, alleges that he never received notice of the assessment. Held, the member is liable for the payment. Cuttle v. Concordia Mut. Fire Ins. Co., 287 N. W. 401 (Mich. 1979).

The court points out that the member's failure to receive the notice may be received in evidence on the question as to whether the notice was mailed, but that the only issue that had to be decided by the jury was whether in fact the notice had been mailed.

Recordation Requirements - Application to Chattel Mortgages Executed Prior to Date of Enactment of Recordation Requirement. Institution of Foreclosure Proceedings Renders Recordation Unnecessary.

Chattel mortgage was executed April 28, 1932. In 1935 the legislature of California passed a statute requiring that all chattel mortgages must be recorded within four years from the last recording or be void as against creditors and subsequent purchasers.

On April 24, 1936 mortgagee instituted foreclosure proceedings. Mortgagor's answer to the suit, filed after April 28, 1936 averred that the four year period had elapsed and that the mortgage was no longer effective. In the meantime, creditor tried to levy on property. Mortgagee replied that institution of the foreclosure suit made it unnecessary to record the mortgage. Held, judgment for mortgagee. Security First Nat. Bank of Los Angeles v. Sartor, 93 P. (2d) 863 (Cal. App. 1939).

The court stated that the recordation requirement operated, in effect, as a statute of limitations which goes only to the remedy and not to the substance. Therefore no constitutional provision was violated by the application of the 1935 statute to mortgages executed prior thereto. As to the second point the court held that the institution of the foreclosure proceedings tolled the requirement of recordation, and therefore the mortgage was valid as against creditors and purchasers.

ADMINISTRATIVE INTERPRETATIONS

MISSISSIPPI

Tax Liability of Contractor Constructing Transmission Lines for REA Project.

Contractors are held to be liable for 1% sales tax on total contract price of such projects. The ruling will be prospective only in its application. Op. Atty. Gen., April 21, 1939, Prentice-Hall, St. Local Tax Serv., Miss., Para. 23, 016, Oct. 10, 1939.

TEXAS

Attorney General Rules that REA Cooperatives are Subject to Property Taxes and Exempt from Gross Receipt Taxes.

Op. Atty. Gen., July 17, 1939, Prentice-Hall St. Local Tax Serv., Wyo., Paras. 34, 051, and 50, 016.

The ruling is in complete accord with prior opinions expressed by the Tax Unit of the REA Legal Division.

WYOMING

Sales of Electricity to REA Cooperative Members Subject to Sales Tax.

1935 Sales Tax Law had earlier been held inapplicable to sales of electricity because the statute did not define tangible personal property to include gas and electricity. However, 1937 Sales Tax Law defined tangible personal property as to include personal property which might be weighed or measured. Held, since electricity may be measured it comes within such definition, and rural electric associations are not exempt. Op. Atty. Gen., September 20, 1939, Prentice-Hall, St. Local Tax Serv., Wyo., Para. 23, 041, Oct. 10, 1939. This opinion is now under study by the Tax Unit of the Legal Division.

WASHINGTON

Membership Certificate of Cooperative Held Not to be a "Security" Within Meaning of Securities Act and Therefore Not Required to be Qualified.

Basing this opinion upon the case of Inland Empire Rural Electrification Inc. v. The Department of Public Service, Wash. Sup. Ct., July 10, 1939, (1939) 1 REA L. J. 69, holding that the Washington Department of Public Service has no jurisdiction over REA Cooperatives, the Attorney-General has ruled that a membership certificate of an REA Cooperative does not constitute a "security" within the meaning of the Washington Securities Act and therefore need not be qualified. Ops. Atty. Gen., August 18, 1939, CCH, Stocks & Bonds Law Serv., Para. 7758, Oct. 16, 1939

RECENT STATUTES

ALABAMA

Creation of Municipal Electric Utility Boards.

Statute authorizes the creation of municipal electric utility boards which shall have complete control of municipal electric distribution systems. Ala. Laws 1939, H. B. No. 874, Governor's No. 463, Approved September 22, 1939.

Repeal of Act Authorizing the Creation of the Rural Electrification Authority of Alabama.

The 1935 Act authorizing the creation of the Rural Electrification Authority of Alabama is repealed. Ala. Laws 1939, H. B. No. 305, Governor's No. 281, approved August 24, 1939.

Provision for Acquisition by Municipalities, Power Districts, Etc. of Privately Owned Electric Utility Plants.

A procedure is set up whereby a municipal corporation, county, improvement authority, power district, federal or state governmental agency may engage in the business of furnishing electric service in a territory in which there is in existence at the time a plant or distribution system through acquisition of such plant or distribution system. Ala. Laws 1939, S. B. No. 300, Governor's No. 244 approved August 18, 1939, amended so that the Act shall not apply with respect to any project for which loans or grants have been made or are under contract to be made by the United States through Federal Emergency Administrator of Public Works, the Federal Works Administrator, the Commissioner of Public Works, the Federal Works Agency, and the Public Works Administration. The amendment also provides that the Act shall have no application to Rural Electric Membership Corporation Distribution Systems. Ala. Laws 1939, S. B. No. 495, Governor's No. 414, approved September 12, 1939.

WISCONSINBlue Sky Laws Amended Generally

Wisc. Laws 1939, Chapter 442,
Assembly Bill No. 910, approved September 15, 1939.

BOOK REVIEW

Harvey, Title Closing, Clark Boardman Company, Ltd., New York, 1939, pp XXVI, 434

The author of this volume is a member of the New York Bar and is title closing attorney for one of the large title companies. This is reflected in the book by the number of intensely practical suggestions that could only have been made as the fruit of a ripe experience.

He commences his work with an agenda of the various steps to be taken in the closing of title which agenda should be very helpful to an attorney in planning the methodical handling of a pending transaction. Thereafter, the main body of the book discusses the problems presented in connection with title closing under the following topics: Identity, Locations, Description and Dimensions of the Property, Restrictive Covenants, Easements and Possible Incorporeal Rights, Liens and Encumbrances, Purchase Price, Contract of Sale, Title Search, Objections, Closing, Fees on Closing, Payment of Purchase Price, Delivery, and Recording.

The text is followed by 176 pages of forms. There is an index, which is fair, but no table of cases.

Notwithstanding the rather restricted geographical scope of this book (most

of the authorities cited as well as most of the practical problems refer to New York) it may be of considerable value generally in the handling of a complicated transaction because of the meticulousness with which each problem is discussed. An attorney in Iowa, for example, might find that local laws render it necessary to handle a particular problem in an altogether different fashion than would be necessary in New York, but Mr. Harvey's book would at least indicate that the problem was there. There is room for additional books of this nature, for although works on real property are numerous, the practical considerations involved in the closing of a real estate transaction have not been discussed fully enough.

Lionel M. Summers

LEGAL MEMORANDA RECEIVED IN SEPTEMBER

- A-71 Necessity for Filing of Power of Attorney in Kentucky, Tennessee, Mississippi and South Carolina to Effect Release of Mortgage
- A-77 Power of Minnesota National Bank to Serve as Trustee under a South Dakota Deed of Trust
- A-82 Necessity for Recording Easements.
- A-87 Prohibition Upon Tennessee Municipalities of Levy of Receipts Tax on Corporations.

TAX MEMORANDA

- T-157 Applicability of North Carolina Taxes to Virginia Cooperative Doing Business in North Carolina

LEGAL MEMORANDA RECEIVED IN SEPTEMBER

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| A-68 Requirement of Competitive Bidding For Nebraska Projects With Respect to Supplemental Orders of \$500.00 or more in Excess of the Maximum Contract Price | A-75 Requisites for and Extent of Liability of Surety Under REA Fidelity Bond |
| A-69 Effect of Restriction in Purpose Clause of Montana Electric Cooperative Act to Organization of Cooperatives in Areas Where "service is not otherwise available from existing facilities and plants." | A-76 Application of New Mexico Electrical Administrative Act to Contractors Performing Work for REA New Mexico Cooperatives. |
| A-70 Suggestions for Legislation in re REA Cooperatives in Kentucky, South Carolina, Virginia, West Virginia, North Carolina and Mississippi | A-77 Power of Minnesota National Bank to Serve as Trustee Under a South Dakota Deed of Trust |
| A-71 Necessity for Filing of Power of Attorney in Kentucky, Tennessee, Mississippi and South Carolina to Effect Release of Mortgage | A-78 Possible Methods of Forcing Removal of Telephone Lines From One Side of a Highway to the Other in Missouri |
| A-72 Elimination of "Stock in Trade" Provision for REA Indentures in Texas, Illinois and Minnesota | A-79 Kansas Mortgage Need Not Set Forth the Maturity Date of Note Secured Thereby |
| A-73 Legality of Delegation of Power to Indiana Project Superintendent to Release Portions of Project Area to Private Power Companies | A-79-A Iowa Mortgage Need Not Set Forth the Maturity Date of Note Secured Thereby |
| A-78-A Admission of Corporation to Membership in a Georgia Electric Membership Corporation | A-79-B Indiana Mortgage Need Not Set Forth the Maturity Date of Note Secured Thereby |
| A-74 Liability of Contractor to Employees of Subcontractor Paid Less Than the Minimum Wage Provided in the Construction Contract | A-45-A Validity of Bylaw Provision in Illinois that Vacancies in the Board of Directors Shall Be Filled by the Remaining Directors. |
| | A-80 Applicability of Fair Labor Standards Act to REA Cooperatives |
| | A-81 Mortgagee's right to Take Possession in Michigan Under Terms of Mortgage |

A-82 Necessity for Recording Easements

A-83 The Revenue Capture Provisions of the REA Trust Indenture

A-84 Does a Trust Result From the Conveyance Clause in the Supplements to the Open-end Mortgage Wherein Conveyance is Made to U.S.A. and R.F.C. "as their respective interests... shall appear?"

A-85 Validity and Effect of Stock in Trade Provisions in Missouri Indentures

A-86 Necessity for Expunging Invalid Stock in Trade Provisions in our Texas, Illinois and Minnesota Indentures

A-87 Prohibition upon Tennessee Municipalities of Levy of Receipts Tax on Corporations

A-88 Present REA Administrator is Authorized, under Authority Given by R.F.C. to Former REA Administrator, to Take Action with Respect to Pledged Collateral for and in the Name of R.F.C.

A-89 Proposed Title Retention Provision in REA Form of Michigan "Consumer's Note"

A-90 Necessity of Expunging Invalid Stock in Trade Provision in our Kansas, Oklahoma, Virginia, Wisconsin, North Carolina, Pennsylvania and Louisiana Indentures

TAX MEMORANDA

T-157 Applicability of North Carolina Taxes to Virginia Cooperative Doing Business in North Carolina

T-158 Application of West Virginia Property Taxes to Property Upon Which the Federal Government Has a Lien

T-159 North Carolina Tax Digest

This is one of the series of Tax Digests Now in Preparation by the Tax Unit for each of the 48 states. Each of these is subject to modification upon final review after the entire series has been completed.

RECENT ADDITIONS TO LAW LIBRARY

NEW YORK CONSOL. LAWS (MCKINNEY, CUM. Pamph. Oct. 1939)

KENTUCKY STATS. (BALDWIN, Oct. 1939)

